

Finding 1. Misstatement of Financial Activity

Summary

During audit fieldwork, a comparison of NCF's reported financial activity with its bank records revealed that, for 2008, NCF understated reported receipts and disbursements by \$69,339 and \$100,887, respectively, and overstated ending cash-on-hand by \$31,448. In response to the Interim Audit Report recommendation, NCF amended its reports to materially correct the misstatements.

The Commission approved the finding that NCF misstated its financial activity.

Legal Standard

Contents of Reports. Each report must disclose:

- the amount of cash-on-hand at the beginning and end of the reporting period;
- the total amount of receipts for the reporting period and for the calendar year;
- the total amount of disbursements for the reporting period and for the calendar year; and
- certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 2 U.S.C. §434(b)(1), (2), (3), (4) and (5).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff reconciled reported financial activity with bank records for calendar year 2008. The following chart outlines the discrepancies for the receipts, disbursements, and the ending cash balance. The succeeding paragraphs explain why the differences occurred.

2008 Activity			
	Reported	Bank Records	Discrepancy
Opening Cash Balance @ February 4, 2008	\$0	\$0	\$0
Receipts	\$1,866,245	\$1,935,584	\$69,339 Understated
Disbursements	\$1,796,773	\$1,897,661	\$100,887 Understated
Ending Cash Balance @ December 31, 2008	\$69,372 ¹	\$37,923	\$31,448 Overstated

The understatement of receipts resulted from unidentified differences that occurred primarily during the 2008 year-end report period. Based on a limited review of available

¹ This column and the discrepancy column do not total correctly. The reported ending cash balance at December 31, 2008, is \$100 less than the reported receipts minus the reported disbursements for the period due to a \$100 discrepancy between the reported ending cash on one report and beginning cash on the succeeding report.

records, it appeared that all contributor information received by the vendor that processed deposits of contributions may not have been forwarded to the vendor responsible for the data entry.

The understatement of disbursements resulted from the following:

• Disbursements not reported	\$ 96,398
• Reported disbursements not supported by a check or debit	(2,596)
• Contribution refunds not reported	7,433
• Amounts incorrectly reported	(696)
• American Express charges not reported	522
• Unexplained difference	<u>(174)</u>
Net Understatement of Disbursements	<u>\$ 100,887</u>

The \$31,448 overstatement of the ending cash-on-hand resulted from the misstatements described above.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff explained the misstatements and provided schedules to NCF's Treasurer and Assistant Treasurer, who agreed to amend reports as necessary.

The Interim Audit Report recommended that NCF:

- Amend its reports to correct the misstatements noted above; and
 - Amend its most recently filed report to correct the cash-on-hand balance with an explanation that the change resulted from a prior period audit adjustment.
- Further, NCF should have reconciled the cash balance of its most recent report to identify any subsequent discrepancies that may affect the adjustment recommended by the Audit staff.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, NCF filed amended reports for 2008 that materially corrected the misstatements.

D. Draft Final Audit Report

In the Draft Final Audit Report, the Audit staff acknowledged that NCF amended its reports to correct the misstatements.

E. Committee Response to the Draft Final Audit Report

In its response to the Draft Final Audit report, NCF did not address this matter.

Commission Conclusion

On August 23, 2012, the Commission considered the Audit Division Recommendation Memorandum in which the Audit Division recommended that the Commission adopt a finding that NCF misstated its financial activity for 2008.

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The Commission approved the Audit staff's recommendation.

Finding 2. Failure to File Notices and Properly Disclose Independent Expenditures

Summary

During audit fieldwork, the Audit staff ascertained that NCF disclosed independent expenditures, totaling \$1,548,622, on Schedule E (Itemized Independent Expenditures). The Audit staff noted that only \$1,261,206 of these expenditures appeared to meet the definition of independent expenditure and contained language expressly advocating the election or defeat of a clearly identified candidate. Of these independent expenditures NCF:

- did not file 24/48-hour notices for \$1,153,748 in a timely manner and did not file any 48-hour notices for \$51,130; and
- did not properly disclose independent expenditures totaling \$528,662 made (i.e., publicly disseminated) prior to payment as "memo" entries on Schedule E and as a debt on Schedule D (Debts and Obligations).

In response to the Interim Audit Report recommendation, NCF provided information supporting its position that the purpose of its direct-mail letters was fundraising and did not require reporting as independent expenditures. Regarding the Audit staff's recommendation that NCF submit and implement revised procedures for reporting independent expenditures, NCF indicated that it plans to terminate after the audit is completed.

The Commission approved the finding that, for specific communications, NCF failed to file notices and properly disclose independent expenditures. The Commission concluded that of the \$1,261,206 in expenditures that the Audit staff identified, \$1,061,853 should have been reported as independent expenditures. Therefore, the Commission approved a finding that NCF did not timely file 24/48-hour notices of \$946,596 and did not file 48-hour notices for \$51,130 and did not properly disclose independent expenditures totaling \$447,413 prior to payment as "memo" entries.

Legal Standard

- A. Definition of Independent Expenditures.** The term "independent expenditure" means an expenditure by a person for a communication expressly advocating the election or defeat of a clearly identified candidate that is not made in coordination with any candidate or authorized committee or agent of a candidate. 11 CFR §100.16.
- B. Disclosure Requirements – General Guidelines.** An independent expenditure shall be reported on Schedule E if, when added to other independent expenditures made to the same payee during the same calendar year, it exceeds \$200. Independent

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expenditures made (i.e., publicly disseminated) prior to payment should be disclosed as "memo" entries on Schedule E and as a debt on Schedule D. Independent expenditures of \$200 or less do not need to be itemized, though the committee must report the total of those expenditures on line (b) on Schedule E. 11 CFR §§104.3(b)(3)(vii), 104.4(a) and 104.11.

- C. Last-Minute Independent Expenditure Reports (24-Hour Notices).** Any independent expenditures aggregating \$1,000 or more, with respect to any given election, and made after the 20th day but more than 24 hours before the day of an election, must be reported and the report must be received by the Commission within 24 hours after the expenditure is made. A 24-hour notice is required each time additional independent expenditures aggregate \$1,000 or more. The date that a communication is publicly disseminated serves as the date that the committee must use to determine whether the total amount of independent expenditures has, in the aggregate, reached or exceeded the threshold reporting amount of \$1,000. 11 CFR §§104.4(f) and 104.5(g)(2).
- D. Independent Expenditure Reports (48-Hour Notices).** Any independent expenditures aggregating \$10,000 or more with respect to any given election, at any time during a calendar year, up to and including the 20th day before an election, must be disclosed within 48 hours each time the expenditures aggregate \$10,000 or more. The notices must be filed with the Commission within 48 hours after the expenditure is made. 11 CFR §§104.4(f) and 104.5(g)(1).

Facts and Analysis

A. Facts

During audit fieldwork, Audit staff noted that NCF's initial filing for 2008 (the April 15th Quarterly Report) disclosed all expenditures as operating expenditures on Schedule B, Line 21(b). On July 11, 2008, NCF amended that report and disclosed most of the former operating expenditures as independent expenditures on Schedule E and Line 24 of the report. During the remainder of 2008, NCF filed reports that disclosed the majority of its disbursements as independent expenditures.

NCF disclosed independent expenditures, totaling \$1,548,622, on Schedule E. Most of these disbursements were for the printing and postage costs for direct mail solicitation letters that were disclosed as either in support of Rudy Giuliani or John McCain for President or in opposition to Hillary Clinton or Barack Obama for President. The Audit staff reviewed these expenditures to assess whether NCF properly reported them on Schedule E and if 24/48-hour notices were required to be filed. The review indicated that only \$1,261,206 of these expenditures appeared to meet the definition of an independent expenditure and contained language expressly advocating the election or defeat of a clearly identified candidate. A review of the direct mail pieces and invoices for those expenditures (\$1,261,206) revealed the following:

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- NCF did not file in a timely manner 24/48-hour notices of its independent expenditures for \$1,153,748. In addition, NCF did not file any 48-hour notices for \$51,130.
- NCF reported the independent expenditures when the invoices were paid; some payments were weeks or months after the dissemination date of the printed material. For expenditures totaling \$528,662, NCF should have disclosed independent expenditures as memo entries on Schedule E, filed with reports covering the dates when the materials were disseminated, and included a corresponding debt on Schedule D.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff addressed these matters and provided schedules detailing these expenditures to NCF representatives. NCF representatives stated that they would comply with the recommendation.

The Treasurer later emailed the Audit staff NCF's position regarding independent expenditures. The email stated:

*"Political fundraising letters that are not intended to influence a vote, not timed to a particular election, but which are intended solely to motivate a donation for the group (and which have words of express advocacy in them) should be excluded from the definition of independent expenditure for your extraordinary reporting purposes, as I stated to you. I have previously written to the FEC on these views and spoken to reporters about them as well. When the FEC pushes administrative overhead activities like general fundraising into IE status, it creates a costly regulatory burden for small donor committees like ours that do not have the financial backing, permanent staff, and infrastructure to keep up with the filings. Hardly any public purpose is served by the extraordinary reporting requirements imposed on just a fundraising letter, and the public is indeed misled (sic) by the artificial inflation in dollars spent on IEs the current requirements cause. In the last election, I fielded questions about the National Campaign Fund from reporters of the *Huffington Post* and the *New York Times* who relied on the IE expense compilations as indications of actual IE activity in direct mail. I told both that the FEC requirements mislead the public in the true nature of the expenditures, and both the reporters agreed with me."*

Subsequent to the exit conference, the Audit staff made additional requests to NCF for documentation and explanations to clarify whether some of the communications resulted in independent expenditures. NCF was asked to clarify how some of the communications were distributed and to provide the content of hyperlinks that were contained in those communications. In addition, NCF was requested to explain why some of the communications did not appear to correlate with the mailing dates. NCF responded by stating that the communications in question were "e-mailings" and provided the content for one of the e-mailings. NCF also explained that it revised the communication multiple times for each mailing but did not keep previous versions of the communication, and

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therefore was unable to provide the previous versions. NCF's responses have been considered in the analysis of independent expenditures presented above.

The Interim Audit Report recommended that NCF take the following action:

- Provide any documentary evidence that would demonstrate that these disbursements were not independent expenditures and therefore did not require 24/48-hour notices; and
- Submit and implement revised procedures for reporting independent expenditures, as well as for tracking dissemination dates for such expenditures to allow for timely filing of 24/48-hour reporting notices.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, NCF offered background information for why it was created and the purpose of its direct-mail fundraising letters. NCF explained that it was formed in 2008 as a non-connected, political action committee (PAC) that was not supported by any sponsoring organization such as a labor union or corporation. There was no permanent staff, office or office equipment. It was formed with the intention of raising funds to allow it to participate in the 2008 general election by making direct contributions to candidates for federal office. NCF indicated that it was the epitome of a "grass roots" attempt to participate in the 2008 federal elections.

NCF explained that its direct-mail advisors obtained lists of proven donors to Republican and conservative causes and tested various content appeals in the letters to these donors. The various tests included content with references to elected officials and presidential candidates to clue the recipient audience that NCF was a conservative Republican PAC worthy of their support. NCF stated that the purpose of these mailings was not to intervene in any election. NCF indicated that the facts demonstrated that: the timing of all of its mailings had no reference to the timing of primary elections during 2008; the content of the letters, other than sometimes including some words considered "express advocacy" by the Commission, did not urge the recipient audience to vote for any particular candidate; and the audience was selected for its fundraising value, with no consideration for its electoral value. Thus the expenditures' content, timing and distribution, and audience served a fundraising purpose but not an electoral purpose.

NCF disagreed that any of its direct-mail fundraising letters constituted independent expenditures. NCF noted that the Commission defines an independent expenditure at 11 CFR §100.16 as a communication expressly advocating the election or defeat of a clearly identified candidate. NCF acknowledged that some of its mailings did include words of express advocacy. However, NCF thought that if the Commission considered all of the facts, it should agree that NCF's fundraising letters were not independent expenditures and that the special reporting rules applicable to independent expenditures (such as the 24/48-hour notices or memo entries) should not apply. NCF stated that it believes that direct-mail fundraising letters should be excluded from the definition of independent expenditures, and that the intent of the regulation was not to include direct-mail fundraising expenditures as independent expenditures. NCF urged the Commission to reform its reporting requirements for grass-roots organizations that engage in direct-mail

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fundraising since NCF believes that these letters are not independent expenditures. NCF indicated that a decision has been made that the time requirements, coordination and record keeping are not worth the effort of continuing to participate and as such, plan to terminate the committee after the audit is completed.

The Audit staff does not dispute that NCF's intention was to raise funds. However, NCF acknowledged, and the Audit staff agreed, that some of these letters included express advocacy language such as "Vote for John McCain." Since these expenditures meet the definition of an independent expenditure and the regulation does not exclude direct-mail fundraising letters from the definition, the Audit staff believes that the documentary evidence provided does not support NCF's assertion that none of these expenditures are independent expenditures.

D. Draft Final Audit Report

The Draft Final Audit Report concluded communications totaling \$1,261,206 appeared to meet the definition of independent expenditure and contained language expressly advocating the election or defeat of a clearly identified candidate. For some of these independent expenditures, NCF failed to file or timely file 24/48-hour notices and properly disclose these independent expenditures as "memo" entries.

E. Committee Response to the Draft Final Audit Report

In response to the Draft Final Audit Report, NCF maintained its position that these were fundraising letters not intended to influence a vote. The response raised three points as to why the communications at issue are not independent expenditures:

- First, NCF contended that the communications were not independent expenditures because the timing of the communications was not related to the timing of the 2008 primary elections. The response referenced Internal Revenue Service Ruling 2004-6 (IRS 2004-6) which applied a "facts and circumstances" test to determine whether a communication by a tax-exempt organization is subject to penalty for engaging in political campaigns. The factor cited therein was whether "the timing of the communication coincides with an electoral campaign."
- Second, NCF stated that the direct-mail letters did not target voters in a particular election. NCF sought lists of proven donors to Republican and conservative causes without regard to whether the listed donors had any propensity to vote, or were even registered voters. Again the response cited IRS 2004-06 and also pointed out that one of the factors considered was whether the communication targeted voters in a particular election.
- Finally, NCF's response asserted that the occasional inclusion of express advocacy references in the direct-mail letters should not mean that the letters meet the definition of independent expenditures.

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The Audit staff was not persuaded by NCF's response. The IRS 2004-06 standards cited are not applicable because the standards for determining when a communication includes express advocacy are set forth in the Commission's regulations at 11 CFR §100.22. The Revenue Ruling and the Commission's regulations serve different purposes. The Revenue Ruling is focused on whether certain organizations can engage in specific kinds of activities and maintain their tax-exempt status, whereas the Commission's express advocacy regulations serve as one of the elements for determining whether a communication will be considered an independent expenditure (See 11 CFR. §100.16(a)). In addition, the Commission has not incorporated the standards from the Revenue Ruling by reference. Therefore, the standards of timing of the communication and targeting of voters should not be used in determining whether the communications in this case are independent expenditures.

With respect to NCF's argument about the occasional inclusion of express advocacy references in the letters, the Commission's regulations on express advocacy do not include a limitation or an exception for only occasional inclusion of express advocacy. A communication containing express advocacy for a clearly identified candidate that is not coordinated with a candidate or candidate's committee or its agents, or a political party committee or its agents, and which is not otherwise exempt, is an independent expenditure.

The Audit staff maintains that NCF did not timely file 24/48-hour notices for \$1,153,748; did not file 48-hour notices for \$51,130; and, did not properly disclose independent expenditures totaling \$528,662 prior to payment as memo entries.

Commission Conclusion

On August 23, 2012, the Commission considered the Audit Division Recommendation Memorandum in which the Audit Division recommended that the Commission adopt a finding that NCF did not timely file 24/48-hour notices of \$1,153,748 and did not file 48-hour notices for \$51,130² and did not properly disclose independent expenditures totaling \$528,662 prior to payment as "memo" entries.

The Commission approved this finding with respect to specific communications (See Additional Issue below). The Commission concluded that of the \$1,261,206 in communications discussed above, \$1,061,853 should be considered to contain express advocacy. Therefore, the Commission approved a finding that NCF did not timely file 24/48-hour notices of \$946,596 and did not file 48-hour notices for \$51,130 and did not properly disclose independent expenditures totaling \$447,413 prior to payment as "memo" entries.

² Due to a formula error, the amount had been improperly presented as \$33,485 in the Interim Audit Report, the Draft Final Audit Report and the Audit Division Recommendation Memo.